

Service Date: March 15, 1995

DEPARTMENT OF PUBLIC SERVICE REGULATION
BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MONTANA

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IN THE MATTER of the Application of)	UTILITY DIVISION
Midvale Water Service for Authority)	
to Increase Rates and Charges for Water)	DOCKET NO. 93.12.64
Service to its Eureka, Montana)	
Customers.)	ORDER NO. 5785a

APPEARANCES

FOR THE APPLICANT:

Edward Thatcher, Manager, Midvale Water Service, P.O. Box 377, Eureka, Montana 59917

FOR THE INTERVENORS:

Mary Wright, Staff Attorney, Montana Consumer Counsel, 34 West 6th Avenue, P.O. Box 2021703, Helena, Montana 59620-1703

FOR THE COMMISSION:

Denise Peterson, Staff Attorney, and Ron Woods, Rate Analyst, 1701 Prospect Avenue, P.O. Box 202601, Helena, Montana 59620-2601

BEFORE:

BOB ROWE, Commissioner and Hearings Examiner

BACKGROUND

1. On March 10, 1994 Midvale Water Service (Applicant or Midvale) filed an application with the Montana Public Service Commission (Commission) amending its initial application of December 16, 1993 for authority to increase water rates and charges to its Eureka, Montana customers. Midvale proposed a rate increase of approximately 220 percent for a revenue

increase of approximately \$65,193. Midvale also filed an application for an interim increase in rates of 136 percent, for a revenue increase of approximately \$40,352 or 62 percent of the proposed permanent increase.

2. On May 16, 1994 the Commission issued Order No. 5785 granting Midvale interim relief in the amount of \$19,369 (Rowe and McCaffree dissenting).

3. On December 7, 1994 the Commission conducted a properly noticed public hearing on the application for rate increase at the Lincoln Electric Cooperative, Eureka, Montana. At the conclusion of the public hearing the parties stipulated to the issuance of a final order in this Docket.

4. At the public hearing the Applicant presented the testimony and exhibits of Edward Thatcher on Midvale's financial statements, its capital needs, and the general overall operation of Midvale Water service. Montana Consumer Counsel (MCC) presented the testimony of 13 public witnesses who expressed concern about the magnitude of the proposed rate increase and their ability to pay the rates requested by Midvale. Some of the witnesses also provided testimony expressing concerns over service problems at their locations.

FINDINGS OF FACT

Revenue Requirement

5. In its filing Midvale identified 21 line item expenses that it determined recoverable through rates and proposed adjustments to 16 of these expense items.

6. Mr. Thatcher admitted that Midvale's proposed increase of 1993 test year "Accounting" expenses from \$1,223 to \$4,800 was an arbitrary increase. Pursuant to ARM 38.5.106, an expense adjustment must be "known with certainty and measurable with reasonable accuracy" to be accepted by the Commission. An expense which cannot be verified with certainty does not meet the criteria for acceptable expense adjustments. The Commission finds that the request for recognition of increased accounting expense should be denied and that Midvale's accounting expenses are \$1,223.

7. During the 1993 test year Midvale's books and records reflect no expense for "Business Licenses and Dues." As a pro forma adjustment Midvale proposed that the Commission recognize an expense of \$175. Midvale's testimony indicates that these expenses were paid

personally rather than being charged to the expenses of the utility operation. The Commission finds Midvale's request to recover \$175 for "Business Licenses and Dues" is reasonable.

8. Midvale's financial statements show test year "Contract Labor" expenses of \$2,072. For pro forma purposes Midvale has increased this expense by \$1,500 to pay for the services of a consulting engineer. Midvale explains that in connection with proposed highway reconstruction it will need to relocate certain water lines, requiring Midvale to retain the services of a consulting engineer to design and supervise construction of the new lines. The engineering expense Applicant proposes to incur, however, is speculative and unknown. It is also not known what financial assistance Midvale may receive from the state for relocation of the lines during the highway construction. The proper time to apply for this expense is when it has been incurred or is known with certainty and documented to be the responsibility of the water company. At that time, Midvale should apply for a rate increase and request any resulting rate-base items as well. The Commission finds that Midvale's "Contract Labor" expense should be \$2,072.

9. Midvale has an outstanding loan with Department of Natural Resources and Conservation (DNRC) with an annual principal and interest payment of \$10,683. This expense was not contested and is therefore accepted by the Commission.

10. For pro forma purposes Midvale is requesting recovery of \$5,731 in depreciation expense. While depreciation expense is recoverable as a cost-of-service, the Commission finds that Midvale should not be allowed to recover this depreciation expense from its ratepayers. There are two sources of funding for Midvale's investment in plant-in-service, owner-financing and an outstanding loan from DNRC. As Midvale and DNRC agreed in the debt instrument, Midvale has requested recovery of the principal and interest associated with the loan as an operating expense. With the loan obligation recovered as an operating expense, Midvale cannot recover the same expense as depreciation expense, or it would recover the cost of these assets from its ratepayers twice.

11. A regulated utility is entitled to earn a "return on" and a "return of" the original cost value of its plant-in-service where it has at risk any of its financial resources. Midvale has never provided the Commission with the original cost value of its plant. Through late filed exhibits, Midvale unsuccessfully attempted to develop the original cost value of its plant. Midvale provided

original cost information which relied solely on estimated costs for supplies and materials used to construct utility facilities without any original cost documentation. The Commission finds that the Applicant's request for depreciation expense should be denied.

12. Midvale proposed an annual expense of \$1,900 for equipment, indicating that if this expense is allowed it will purchase such items as pumps, controls, pipe, and backhoe. These items are capital in nature; over their useful lives they will produce benefits for future periods. In the regulatory arena privately-owned utilities are expected to attract the capital (debt and equity) necessary to obtain capital items essential for the operation of the utility. Once the capital items become "used and useful" in utility operations, the capital investment is returned to the utility through depreciation expense over the life of the asset. Since the items proposed to be expensed are capital in nature, the Commission finds that the request to recover \$1,900 annually should be denied.

13. During the 1993 test year Midvale incurred \$11,000 in "Administrative and General" expenses. Midvale proposes to reduce this expense item by \$5,000, recognizing that the incurred expenses were rate-case related and will not be recurring. The Commission finds that the Applicant's proposed "Administrative and General" expenses should be \$6,000. This expense was calculated at \$500 per month for the services of the owner/founder/consultant, Mr. Thatcher's father. The Commission finds, however, that this item will reduce the acceptable level of "Salary and Wages" expense, as it is more properly in that category.

14. The owners of the Midvale water system have never charged "Maintenance" expense to the utility operation, but have personally paid these expenses. For pro forma purposes Midvale proposes that it be allowed to recover \$1,300 for maintenance of the water system. This expense was not contested and the amount appears to be within a realm of reasonableness. The Commission finds that the Applicant's "Maintenance" expense of \$1,300 is reasonable.

15. Midvale proposes no pro forma adjustments to the test year "Materials" expense of \$341. The Commission finds that the Applicant's "Materials" expense is \$341.

16. During the 1993 test year Midvale incurred \$86 in "Miscellaneous" expenses. For pro forma purposes Midvale proposes that it be allowed \$1,000 in "Miscellaneous" expenses. The testimony revealed that the \$1,000 expense level was arbitrary and unsupported. Utility operations incur unanticipated expenses which should be recovered from the ratepayer, but the Commission

cannot support the magnitude of increase in this expense when measured against actual experience.

Without any evidence on the record, the Commission will allow as reasonable a miscellaneous expense of \$100. The Commission is allowing other expenses previously covered by the owner personally, which should allow recovery of documented miscellaneous expenses, as well as expenses it expects to incur, such as insurance expenses.

17. To calculate a normalized "Purchased Power" expense, Midvale averaged the billings received during 1992 and 1993 and added known and measurable increases to the purchased power charges from its electric service supplier. Midvale calculated that its normalized "Purchased Power" expense would be \$1,734 which the Commission finds is reasonable.

18. Midvale presented testimony that it had incurred rate case expenses totalling \$9,022 which it wished to recover over a two-year period. In this proposed expense, Applicant requested recovery of \$2,647 for accounting, \$605 for legal, \$150 for postage and office, \$320 for mileage (1,200 miles at .25/mile), \$320 per diem (four days at \$80 per day), and \$5,000 for the owner (25 percent of salary, for March to December, 1993). Much of the expense incurred in this case resulted from obtaining experience on the job and not having available adequate assistance in Eureka. While the Commission respects the Applicant for becoming knowledgeable, the Commission cannot allow recovery in rates for on-the-job training at levels higher than counsel and accountant, combined. Pro se parties do not get attorney fees. The 25 percent salary expense is covered in the "Salary and Wages" category, although not at the level requested by Applicant. A generous rate case expense for a utility as small as Midvale would be \$3,600. Amortizing this expense over two years, the Commission finds that Midvale should be allowed to recover \$1,800 annually for rate case expense.

19. The 1993 test year expense for "Regulatory Expense" was \$682, Midvale's pro forma expense for this account is \$130. Midvale reduced these expenses because costs were improperly charged to the account. The Commission finds that Midvale's proposed Regulatory Expense of \$130 is reasonable.

20. During the 1993 test year, Midvale's "Salary and Wages" expense totalled \$16,000. For pro forma purposes Midvale has increased this expense by \$14,400 to a total of \$30,400. Midvale proposes to pay a part-time employee \$6,400 and to pay Applicant as the water plant

manager \$2,000 per month. Applicant testified that this monthly salary is reasonable since the entire operation of the utility is his responsibility and he has to be available on a full-time basis.

21. Based on costs and operations of similarly situated utilities, however, the Commission cannot find the proposed salary expense reasonable. The Commission regulates numerous small utility operations (less than 200 connections) under its jurisdiction. Generally small privately-owned water utilities in more populous areas contract out the services proposed to be rendered by Midvale's water plant manager. The range of costs for these contracted services has been \$400 to \$800 per month (see Docket No. 94.1.3, Order No. 5773b), significantly lower than the salary proposed by Midvale. For small utility operations where this service is provided by the owner or an employee of the utility, the Commission has seen salary requests in the range of \$0 to \$1,075 (see Docket Nos. 91.2.3 and 94.3.14). The upper level of compensation accepted by the Commission for the services of an operator is \$1,075 on a customer base of 150. The compensation levels for similar services do not approach the level requested by Midvale. Although the plant operator must be available on a full-time basis, the job does not constitute full-time employment. Most small utilities are doing the job for the price of a part-time employee.

22. Here, the salary cost for Midvale's part-time employee(s) should take care of the needs of a utility with 88 customers. The customer base and size of the utility operation cannot support the need for a full-time employee at the cost proposed. Nevertheless, for this case the Commission finds that a salary cost of \$1,000 per month for water plant operations would be reasonable. Incorporated into this salary level is \$6,000 to the former owner as consultant (see Administrative and General Expenses). The Commission realizes that the Applicant has put extra effort into bringing service up to standard since returning to Montana. Therefore, recognizing the salary expense actually incurred in the test year, the Commission will allow the test year expense of \$16,000 for salary and wages. However, the Commission will reduce this expense to \$10,000 in this category, since a \$6,000 expense is incurred for a consultant salary expense. The Commission respects the efforts of the Applicant and the former owner who is now a consultant. Regretfully, this small utility cannot support them both and another part-time employee as well.

23. The test year operating statements of Midvale reflect no costs for insurance. In the pro forma statement Midvale proposes to recover insurance costs totalling \$11,520 for Commercial

Liability (\$1,523), Vehicle (\$718), Workman's Compensation (\$3,879) and Health Insurance (\$5400). Midvale's proposal to recover Commercial Liability, Vehicle and Workman's Compensation insurance costs is acceptable as these costs are necessary insurance costs recoverable from ratepayers. These pro forma expenses have not been recovered from ratepayers. Recovering these legitimate expenses in rates will help the bottom line of this small utility.

24. The request to recover health insurance costs from ratepayers, however, warrants examination. The proposal to provide health insurance for current and retired employees of Midvale is presented for first time in this Docket. Midvale proposes to pay the health insurance premiums for the present manager and the retired owner at an annual cost of \$5,400. The retired owner of the system did not receive a health insurance benefit while employed by the utility and was under no agreement providing that the company would provide this benefit the company on his retirement. The Commission finds that the request to pay the health insurance premium of the retired owner should be denied. It is not the responsibility of ratepayers to provide funding for retiree benefits implied or contracted for by management after the date of an employee's retirement.

25. Midvale's request to provide health insurance coverage for the current employee should also be denied. Midvale is a very small utility business having significant unavoidable operating expenses that cause its rates to be very high. Provision of the discretionary benefit has to be predicated on the ability of the utility to provide service to customers at affordable rates and the ability of customers to pay. In Eureka, salaries and wages are low and there is significant seasonal employment. Many of the public witnesses testified that Midvale's proposed rate increase would create an economic hardship. The Commission takes administrative notice that other small utilities do not provide health insurance benefits. To allow recovery of the employee health benefit, the Commission would be ignoring the public testimony regarding ability to pay and the unusual nature of this request for a small utility.

26. Midvale's 1993 test year "Water Sampling" costs were \$2,650. For pro forma purposes Midvale is projecting that these expenses will increase to a total of \$3,048. Applicant testified that the Safe Drinking Water Act requires taking additional water samples which will increase its costs. The Commission is aware that the Safe Drinking Water Act has increased the

sampling requirements imposed on a water utility and accepts Midvale's pro forma expense of \$3,048.

27. The 1993 test year operating statements of Midvale includes "Taxes" of \$2,069. Midvale's pro forma operating statement proposes a tax expense of \$4,441. The tax account includes recovery of property taxes, Public Service Commission tax, Department of Health and Environmental Sciences fee, Social Security tax, Federal Unemployment tax, and State Unemployment tax. These are standard tax costs recovered from ratepayers. The Commission finds the proposed expense of \$4,441 to be reasonable.

28. Midvale's actual 1993 telephone charges totalled \$686. The Commission accepts the expense of \$686 as reasonable.

29. Midvale proposed pro forma "Transportation" expense of \$1,183, an increase of \$154 over the actual 1993 expense for this account. Midvale's testimony indicates that the pro forma expense was calculated by increasing the actual 1993 expense of \$1,029 by 15 percent. The Commission finds that the increase in this expense account is not a known and measurable change and should be denied. The Commission finds that for pro forma purposes this expense should be \$1,029.

30. Based on the preceding Findings of Fact the Commission finds that Midvale should be authorized a revenue increase of \$21,763, calculated as follows.

Operating Revenues			\$29,182.00
Operating Expenses			
	Accounting	1,223.00	
	Advertising	63.00	
	Bus. License Dues	175.00	
	Contract Labor	2,072.00	
	DNRC Payment	10,683.00	
	General & Admin.	6,000.00	
	Insurance	6,120.00	
	Maintenance	1,300.00	
	Materials	341.00	
	Miscellaneous	100.00	
	Purchased Power	1,734.00	
	Rate Case Expense	1,800.00	
	Regulatory Expense	130.00	
	Salaries & Wages	10,000.00	
	Water Sampling	3,048.00	
	Taxes	4,441.00	

	Telephone	686.00	
	Transportation	<u>1,029.00</u>	
Total Expenses		\$50,945.00	
Net Loss			\$(21,763.00)

The net loss of \$21,763 calculates to a revenue requirement increase of \$2,394 over the interim revenue requirement increase of \$19,639, to be allotted per customer classifications in the following rate design.

RATE DESIGN

31. The Applicant testified that the proposed rate structure is designed to generate total annual revenues of \$94,825 for an annual revenue increase totalling \$65,643. Midvale proposes to continue an unmetered rate assessment (monthly flat rate) for all commercial and residential consumers. The proposed rate design, however, is different from that currently on file with the Commission. The proposed flat rate design uses billing determinants that produce a variable flat rate for commercial accounts, using an Equivalent Connection Schedule (ECS), and a per worker surcharge for accounts having more than two employees to develop the monthly charge for a specific connection. Midvale also proposes to implement an assessment against vacant lots within its service territory.

32. Midvale did not present a cost of service study in its application. Without such a study, the Commission cannot determine what level of revenue each customer classification should contribute. The rate design, or distribution of the needed revenue among the various customer classes, must be fair and give the consumer the proper price signal to encourage prudent use of a limited resource. A rate design should also avoid or delay future rate increases that could result from unwarranted increases in consumption requiring the construction of additional plant. Without a cost

of service study, the Commission must determine the reasonableness of the proposed rate design using criteria not purely cost of service based.

33. At the public hearing Midvale's witness testified that Midvale's prefiled rate design information reflected customer count, not ECS information. The ECS count, submitted as a late-filed Exhibit by the Applicant, indicates that use of the ECS increases its test year rate design units by a total of .75 equivalent customers, an insignificant difference.

34. When cross-examined on the ECS, the Applicant's witness was unable to provide the Commission with the base unit of measure for the ECS, i.e., the equivalent of 1.00. The witness did not know whether the base unit was a residential connection with irrigation requirements, a residential connection without irrigation requirements, a commercial connection or some other basis for measurement. Without knowing the base unit of measure, the Commission cannot determine the reasonableness of the Applicant's proposal to use the ECS for purposes of calculating rates. The Commission finds that the Applicant's request to use the ECS for purposes of designing rates should be denied.

35. The Commission, rejecting Midvale's proposed rate design, must specify a rate structure that will allow the Applicant the opportunity to generate the authorized revenue requirement. The Commission finds that the Applicant should continue the water rate structure presently in effect, adding the workers surcharge and the vacant lot charge.

36. Midvale proposes that it be allowed to implement a per employee surcharge of \$3.00 per month on its commercial accounts that have more than two employees. Midvale asserts that implementation of this surcharge would recognize that these businesses use more water because of the higher employment level. Midvale also maintains that such a fee would keep the monthly flat rate for small commercial accounts lower and introduce some equity into the commercial fee schedule. The Commission accepts Midvale's rationale for proposing implementation of such a fee as reasonable.

37. Midvale has proposed to implement a \$0.10 per linear frontage foot charge to be assessed against vacant lots in its service area. Midvale maintains that the vacant lots in its service territory should be responsible for repayment of some costs associated with the 1988 system upgrades mandated by the Montana Department of Health and Environmental Sciences. Since these

upgrades were undertaken to meet the water quality requirements and to insure the availability of water to all potential connections in its service area, Midvale asserts that active accounts should not be solely responsible for these costs.

38. The Commission agrees with Midvale that vacant lots should absorb some of the costs associated with the 1988 upgrades. Vacant lots receive benefits of these upgrades. The small customer base presently connected to the system and receiving service should not be obligated to carry the revenue burden of fixed costs and capital costs for maintaining service availability to undeveloped lots. The Commission finds that Midvale should be authorized to implement a "Vacant Lot" charge and assess such charge against all lots within its service area that have mains adjacent to the property, but no service connection. The Commission however does not accept Midvale's proposal to implement a \$0.10 per linear foot charge, which Mr. Thatcher indicated had no cost basis.

39. The costs associated with the 1988 upgrades were financed with a loan from DNRC. The annual DNRC debt repayment of \$10,683 can be used as a cost basis for allocating costs between active customers and the vacant lots. Based on the information in the filing there are 88 active customers on the system and 136 vacant lots for a total number of possible connections of 224. Vacant lots should pay \$48 annually for their share of the costs associated with the 1988 upgrades, based on dividing the annual payment by the total number of possible connections ($\$10,683 - 224 = \47.69).

40. The total revenue requirement recognized in this order is \$50,945. The vacant lot charges and employee surcharge will generate \$8,688 in annual revenues for Midvale [$(136 \times \$48.00) + (60 \times \$3.00 \times 12) = \$8,688.00$]. Midvale will be required to generate the balance of its revenue requirement, \$42,257, from the remainder of its rate schedule. Without a cost-of-service study the Commission cannot determine the exact amount of revenue that should be collected from each customer class. The Commission, therefore, finds that a uniform percentage increase in rates to the remainder of the customer classifications is the fairest way to implement the authorized revenue increase. To the classifications other than the new rate classes (vacant lots and commercial employee surcharges), the rates and charges of Midvale should be increased by 44.8 percent over the rates in place before the interim order. Residential customers and customers not affected by the

employee surcharge will see a rate reduction over their rates in place after the interim, which increased their rates approximately 66 percent.

RULES OF SERVICE

41. Midvale proposes amendments to its rules of service. There is a conflict between some of the rules filed by the Applicant and the Commission's "General Rules For Privately-Owned Water Utilities." ARM 38.5.2501(2) provides that if there is a conflict between the special rules and the general rules, the general rules govern.

42. Midvale's Special Rule No. 1 is in conflict with ARM 38.5.2505(1)(b) as it relates to notice of discontinuance of service to the consumer. Midvale should amend the rule to conform the notification requirements with the cited rule.

43. Special Rule No. 5 as proposed by Midvale violates ARM 38.5.2504(2). Midvale's rule provides a charge for disconnecting and reconnecting service when a consumer requests temporary discontinuance of service. The general rule provides that the utility may assess a reconnection charge on a consumer's request for temporary discontinuance of service. Midvale's request to implement a \$30 disconnection charge is denied.

44. In its Special Rule No. 6 Midvale proposes to assess a consumer whose service has been disconnected for non-payment of services a reconnection fee of \$50. Special Rule No. 5 provides for a \$30 reconnection charge on a consumer's request for temporary discontinuance of service. The disconnection activity of the utility is identical for non-payment and temporary discontinuance. Therefore, no difference in the assessment made for reconnection of service is warranted. The Commission finds that Midvale should be authorized a reconnection charge of \$30 when service has been discontinued for non-payment.

45. Customers' service complaints were raised and addressed during the hearing. Many customers agreed that service had improved in the last several years. Some service issues need to be addressed, with the utility and customers working together. The public hearing provided an opportunity for discussion of service and rate issues, laying the groundwork for further cooperation. Applicant and customers alike recognized that the total revenue increase request would have been a burden on Eureka customers. Other small water companies without a large customer base to share

the cost of capital improvements (and often lacking access to favorable financing) have experienced similar upward rate pressure. The solution may be customer acquisition of water systems or consolidation of adjoining systems.

CONCLUSIONS OF LAW

1. Midvale Water Service, Applicant, is a public utility as defined in ' 69-3-101, MCA. The Montana Public Service Commission properly exercises jurisdiction over Applicant's rates and service pursuant to ' 69-3-102, MCA.
2. The Commission has provided adequate public notice and an opportunity to be heard as required by ' 69-3-303, MCA, and Title 2, Chapter 4, MCA.
3. The rates and rate structure approved in this order are just and reasonable. ' ' 69-3-201 and 69-3-330, MCA.

ORDER

THEREFORE, THE MONTANA PUBLIC SERVICE COMMISSION ORDERS THAT:

1. Midvale Water Service shall file rate schedules which reflect an increase in annual revenues of \$21,763 for its Eureka, Montana service area. The increased revenues shall be generated by increasing rates and charges as provided herein. The revenue increase authorized herein is in lieu of, not in addition, to that authorized in Order No. 5785.
2. The rates approved herein shall not become effective until approved by the Commission.
3. The Applicant is authorized to implement rules as provided herein.

DONE IN OPEN SESSION at Helena, Montana this 14th day of March, 1995, by a vote of 4-0.

BY ORDER OF THE MONTANA PUBLIC SERVICE COMMISSION

NANCY MCCAFFREE, Chair

DAVE FISHER, Vice Chair

DANNY OBERG, Commissioner

BOB ROWE, Commissioner

ATTEST:

Kathlene M. Anderson
Commission Secretary

(SEAL)

NOTE: Any interested party may request the Commission to reconsider this decision. A motion to reconsider must be filed within ten (10) days. See ARM 38.2.4806.